

SECTOR UPDATE

Industrial Automation – China

2Q23 Results Wrap-up: Robust Share Gains Offset By Slow Recovery

As foreign brands struggled to destock amid a tough macro environment, domestic automation names maintained the robust momentum in market share gains, with both Inovance and Estun seeing record-high market shares during 2Q23. The market's recovery is slower than expected, but we are starting to see more positive signs, such as a pick-up in demand from cyclical end-markets, and slightly better sentiments from consumer electronic names. Maintain OVERWEIGHT.

WHAT'S NEW

- 2Q23 results wrap-up: Domestic names outperformed on share gains; market conditions below expectations.** Names under our coverage delivered results ranging from in-line to below expectations. Shuanghuan Driveline (Shuanghuan) remained the best performer under our coverage with a 47% yoy net profit growth thanks to a much better-than-expected recovery in its commercial vehicle business, although the slowdown in EV gear business in 2Q was worse than our expectations. Inovance reported an in-line 6% yoy net profit growth, driven by strong share gains in general automation business, and a recovery in its EV business. Estun's earnings surged by 2.4x yoy from a low base, but still missed our and market expectations due to a lower-than-expected growth in its core automation business. Han's Laser remained the worst performer under our coverage due to its large exposure to consumer electronics and cyclicals with earnings declining 6% yoy to Rmb281m, but still saw a strong 98% qoq recovery by a very low base in 1Q23.
- Domestic brands registered robust share gains in 2Q23...** Estun continued the trend of robust share gains in 2Q23, with market share expanding to 9% (+2ppt yoy and 1ppt qoq), surpassing Epson, ABB and Yaskawa to become the second largest industrial robot name in China for the first time. Inovance also registered share gains across all key products, with servo/inverter/small-sized programmable logic controllers (PLC) share expanding to 17.5%/24.3%/15.4% (+2.6ppt/2.8ppt/3.5ppt vs 2022) respectively in 1H23.
- ...and foreign brands were the losers again.** Foreign brands were plagued by share loss amid an on-going import substitution trend, a weaker-than-expected recovery, and the subsequent inventory destocking throughout 2Q. For the June quarter, FANUC was among the worst performers due to its exposure to machine tools and robots, and reported a whopping 41% yoy decline in new orders from China. Yaskawa and Omron were much better off thanks to their exposure to upstream components, with Omron reporting a flattish qoq orders growth in China for the i-automation business, and Yaskawa registering a strong 36% yoy and 97% qoq growth in its AC servo motor business primarily thanks to strong order flow from the solar industry. However, Yaskawa's robotics orders from China still registered a sharp 48% yoy decline. ABB's overall orders growth remained strong at +2% yoy thanks to its exposure to process automation, but its global robotics and China orders still registered a 22% and 9% yoy decline respectively during the period.

OVERWEIGHT
(Maintained)

SECTOR PICKS

Company	Ticker	Rec	Share Price (Rmb)	Target Price (Rmb)
Inovance	300124 CH	BUY	70.11	82.00
Estun	002747 CH	BUY	22.60	31.50

Source: UOB Kay Hian

PEER COMPARISON

Company	Ticker	Rec	Price @ 8 Sep 23 (Rmb)	Target Price (Rmb)	Upside/(Downside) to TP (%)	Market Cap (Rmbm)	PE 2023F (x)	PE 2024F (x)	P/B 2023F (x)	P/B 2024F (x)	ROE (%)	Net Gearing (Cash) (%)
Inovance	300124 CH	BUY	70.11	82.00	17.0	185,511	38.8	32.7	7.9	6.6	19.2	(23.1)
Estun	002747 CH	BUY	22.60	31.50	39.4	19,585	83.5	61.8	6.5	5.9	8.1	81.9
Shuanghuan Driveline	002472 CH	HOLD	33.29	36.20	8.7	28,393	36.2	27.8	3.5	3.1	10.2	1.2
Han's Laser	002008 CH	HOLD	23.71	25.50	7.5	24,937	24.8	20.0	1.9	1.8	5.6	(23.1)

Source: Bloomberg, UOB Kay Hian

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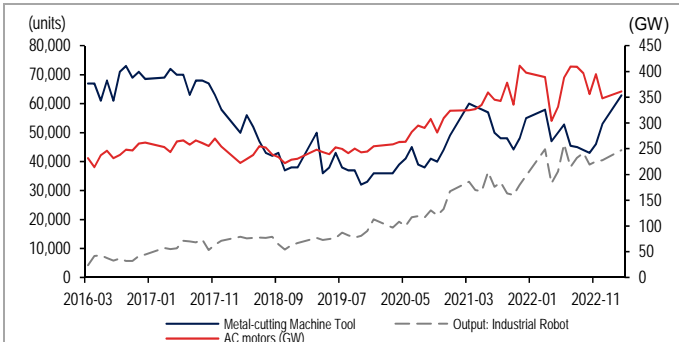
Guidance has turned more cautious for 2H23. Progress of inventory destocking for foreign brands has been slower than expected, and it may take another quarter before inventory levels return to a more normal level. Demand recovery is also rather weak, as the slowdown in EV/Li-ion battery capex was sharper than we had anticipated at the beginning of the year. Domestic names have mostly kept or revised down their full-year guidances – Inovance and Shuanghuan have mostly kept full-year guidance unchanged, while Estun has a more cautious tone on top-line growth due to ASP competition for the robotics business and a weaker-than-expected growth in its core component business. **Opt Machine Vision** (688686 CH/Not rated), a leading domestic machine vision solutions provider, also revised down its full-year top-line growth guidance from 30% to 10% due to a slowdown in both the EV and semiconductor end-markets. **Leader Drive** (688017 CH/Not rated) was among the worst performers in the A share automation space due to its big exposure to light-payload robots and share loss. Most foreign players have turned cautious on China's recovery due to the lack of solid government stimulus, and they are now guiding for a recovery in the China market in 1H24 (vs previous guidance of end-2023)..

Humanoid robot exposure under our coverage. For our coverage, we believe Shuanghuan has the biggest exposure to humanoid robots, as the company should be cooperating with a key North American client on the development of a new planetary reducer for its humanoid robot product. We believe Inovance has also approached the same client for the cooperation of core components. We note that humanoid robots' actual contribution to top-/bottom lines will remain minimal in the coming 1-2 years. Nevertheless, share prices of key stocks may react strongly to newsflow related to the development of humanoid robots.

ACTION

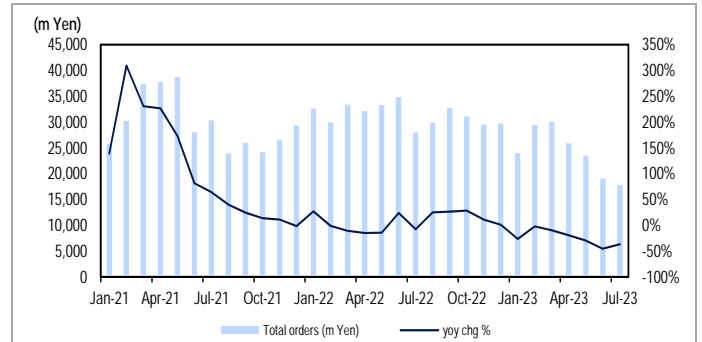
- **Maintain OVERWEIGHT.** Despite a weaker-than-expected recovery, we believe the direction of the overall automation market in China is largely in line with our previous expectations (a slow recovery towards year-end), even though the shipment numbers for industrial robots have been slightly disappointing given the worse-than-expected slowdown in capex in the EV supply chain. As such, we trim our full-year growth estimates for China's industrial robot shipment from +5% to +3% yoy. Our estimates for automation demand remain largely unchanged at -1.4% yoy. Maintain OVERWEIGHT as we expect domestic players to benefit from robust share gains.
- **Inovance (300124 CH/BUY/Target: Rmb82.00).** We believe Inovance as the leader among domestic automation player will benefit the most from the on-going import substitution trend. We also expect Inovance to benefit more from the recovery in broader economy, given their larger exposure to end-markets such as property, semi and consumer electronics. Maintain BUY and keep our target price of Rmb82.00 unchanged, now pegged to 38.3x 2024F PE, on a par with its historical forward mean.
- **Estun (002747 CH/BUY/Target: Rmb31.50).** Despite a worse-than-expected pick-up in industrial robot sales, Estun's share gains have already surpassed our expectations at 9% in 2Q23 (vs our full-year estimates of 8%), primarily driven by its dominance in the solar robotics market. As such, we remain confident in Estun achieving its full-year sales target of >25,000 industrial robots for 2023. From 2024 onwards, growth will be supported by the development of new end-markets and applications, penetration into the automobile value chain, as well as the recovery in consumer electronics as demand growth from solar will likely slow from a high-base. Maintain BUY and keep target price at Rmb31.50, based on 86.1x 2024F PE, which is now based on 0.5SD below historical forward mean.

SALES VOLUME BASED ON MACHINE TYPES



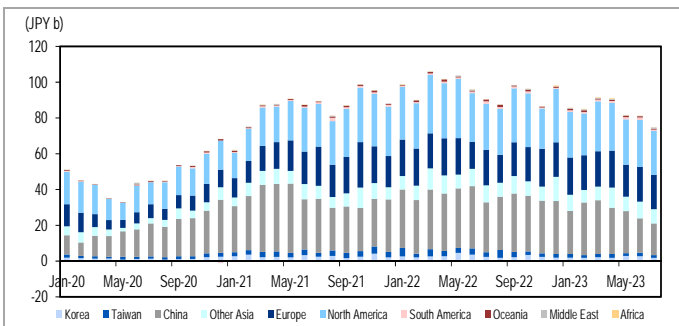
Source: National Bureau of Statistics of China, UOB Kay Hian

JAPANESE MACHINE TOOLS ORDER FROM CHINA



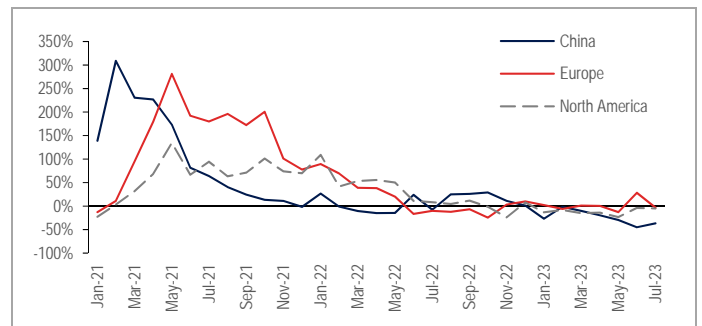
Source: JMTBA, UOB Kay Hian

JAPANESE MACHINE TOOLS SALES VOLUME GEOGRAPHICAL BREAKDOWN



Source: JMTBA, UOB Kay Hian

JAPANESE MACHINE TOOLS YOY GROWTH BASED ON REGION



Source: JMTBA, UOB Kay Hian

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